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delegate will request such a determination where there is a substantial question as to whether a deposit is made in accordance with an agreement.

(i) *Special rules for application of the foreign tax credit*—(1) *In general.* For purposes of computing the limitation under section 904 of the Code on the amount of the credit provided by section 901 of the Code (relating to the foreign tax credit), the party's taxable income from any source without the United States and the party's entire taxable income are to be determined after application of section 607(d) of the Act. Thus, amounts deposited for the taxable year with respect to amounts referred to in section 607(b)(1)(A) of the Act and § 391.2(a)(1)(i) (relating to taxable income attributable to the operation of agreement vessels) shall be treated as a deduction in arriving at the party's taxable income from sources without the United States (subject to the apportionment rules and paragraph (i)(2) of this section) and the party's entire taxable income for the taxable year. Amounts deposited with respect to gain described in section 607(d)(1)(B) of the Act and § 391.2(c) (relating to net proceeds from the sale or other disposition of an agreement vessel and net proceeds from insurance or indemnity) and amounts deposited with respect to earnings described in section 607(d)(1)(C) of the Act and paragraph (b)(2)(ii) (relating to earnings from the investment and reinvestment of amounts held in a fund) of this section are not taken into account for purposes of the Code and hence are not included in the party's taxable income from sources without the United States or in the party's entire taxable income for purposes of this paragraph.

(2) *Apportionment of taxable income attributable to agreement vessels.* For purposes of computing the overall limitation under section 904(a)(2) of the Code the amount of the deposit made with respect to taxable income attributable to agreement vessels pursuant to § 391.2(a)(1)(i) which is allocable to sources without the United States is the total amount of such deposit multiplied by a fraction the numerator of which is the gross income from sources without the United States from the op-

eration of agreement vessels and the denominator of which is the total gross income from the operation of agreement vessels computed as provided in § 391.2(b)(2). For purposes of this paragraph, gross income from sources without the United States attributable to the operation of agreement vessels is to be determined under sections 61 through 863 of the Code and under the taxpayer's usual method of accounting provided such method is reasonable and in keeping with sound accounting practice. Any computation under the per-country limitation of section 904(a)(1) shall be made in the manner consistent with the provisions of the preceding sentences of this paragraph.

§ 391.4 Establishment of accounts.

(a) *In general.* Section 607(e)(1) of the Act requires that three bookkeeping or memorandum accounts are to be established and maintained within the fund: The capital account, the capital gain account, and the ordinary income account. Deposits of the amounts under the subceilings in section 607(b) of the Act and § 391.2 are allocated among the accounts under section 607(e) of the Act and this section.

(b) *Capital account.* The capital account shall consist of:

(1) Amounts referred to in section 607(b)(1)(B) of the Act and § 391.2(a)(1)(ii) (relating to deposits for depreciation),

(2) Amounts referred to in section 607(b)(1)(C) of the Act and § 391.2(a)(1)(iii) (relating to deposits of net proceeds from the sale or other disposition of agreement vessels) other than that portion thereof which represents gain not taken into account for purposes of computing gross income by reason of section 607(d)(1)(B) of the Act and § 391.3(b)(2) (relating to nontaxability of gain from the sale or other disposition of an agreement vessel),

(3) Amounts representing 85 percent of any dividend received by the fund with respect to which the party would, but for section 607(d)(1)(C) of the Act and § 391.3(b)(2)(ii) (relating to nontaxability of deposits of earnings from investment and reinvestment of amounts held in a fund), be allowed a deduction under section 243 of the Code, and

(4) Amounts received by the fund representing interest income which is exempt from taxation under section 103 of the Code.

(c) *Capital gain account.* The capital gain account shall consist of amounts which represent the excess of (1) deposits of long-term capital gains on property referred to in section 607(b)(1) (C) and (D) of the Act and § 391.2(a)(1) (iii) and (iv) (relating respectively to certain agreement vessels and fund assets), over (2) amounts representing losses from the sale or exchange of assets held in the fund for more than 6 months (for purposes of this section referred to as “long-term capital losses”). For purposes of this paragraph and paragraph (d)(2) of this section, an agreement vessel disposed of at a gain shall be treated as a capital asset to the extent that gain thereon is not treated as ordinary income, including gain which is ordinary income under section 607(g)(5) of the Act (relating to treatment of gain on disposition of a vessel with a reduced basis) and § 391.6(e) or under section 1245 of the Code (relating to gain from disposition of certain depreciable property). For provisions relating to the treatment of short-term capital gains on certain transactions involving agreement vessels or realized by the fund, see paragraph (d) of this section. For rules relating to the treatment of capital losses on assets held in the fund, see paragraph (e) of this section.

(d) *Ordinary income account.* The ordinary income account shall consist of:

(1) Amounts referred to in section 607(b)(1)(A) of the Act and § 391.2(a)(1)(i) (relating to taxable income attributable to the operation of an agreement vessel),

(2) Amounts representing (i) deposits of gains from the sale or exchange of capital assets held for 6 months or less (for purposes of this section referred to as “short-term capital gains”) referred to in section 607(b)(1) (C) or (D) of the Act and § 391.2(a)(1) (iii) and (iv) (relating respectively to certain agreement vessels and fund assets), reduced by (ii) amounts representing losses from the sale or exchange of capital assets held in the fund for 6 months or less (for purposes of this section referred to as “short-term capital losses”). For rules

relating to the treatment of certain agreement vessels as capital assets, see paragraph (c) of this section.

(3) Amounts representing interest (not including any tax-exempt interest referred to in section 607(e)(2)(D) of the Act and paragraph (b)(4) of this section) and other ordinary income received on assets held in the fund (not including any dividend referred to in section 607(e)(2)(C) of the Act and paragraph (d)(5) of this section),

(4) Amounts representing ordinary income from a transaction (involving certain net proceeds with respect to an agreement vessel) described in section 607(b)(1)(C) of the Act and § 391.2(a)(1)(iii), including gain which is ordinary income under section 607(g)(5) of the Act and § 391.6(e) (relating to treatment of gain on the disposition of a vessel with a reduced basis) or under section 1245 of the Code (relating to gain from disposition of certain depreciable property), and

(5) Fifteen percent of any dividend referred to in section 607(e)(2)(C) of the Act and paragraph (b)(3) of this section received on any assets held in the fund.

(e) *Limitation on deduction for capital losses on assets held in a fund.* Except on termination of a fund, long-term (and short-term) capital losses on assets held in a fund shall be allowed only as an offset to long-term (and short-term) capital gains on assets held in the fund, but only if such gains are deposited into the fund, and shall not be allowed as an offset to any capital gains on assets not held in the fund. The net long-term capital loss of the fund for the taxable year shall reduce the earliest long-term capital gains in the capital gain account at the beginning of the taxable year and the next short-term capital loss for the taxable year shall reduce the earliest short-term capital gains remaining in the ordinary income account at the beginning of the taxable year. Any such losses that are in excess of the capital gains in the respective accounts shall reduce capital gains deposited into the respective accounts in subsequent years (without regard to section 1212, relating to capital loss carrybacks and carryovers). On termination of a fund, any net long-term capital loss in the capital gain account and any net short-term capital

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loss remaining in the ordinary income accounts is to be taken into account for purposes of computing the party's taxable income for the year of termination as a long-term or short-term (as the case may be) capital loss recognized in the year the fund is terminated. With respect to the determination of the basis to a fund of assets held in such fund, see § 391.2(g).

§ 391.5 Qualified withdrawals.

(a) *In general.* (1) A qualified withdrawal is one made from the fund during the taxable year which is in accordance with section 670(f)(1) of the Act, the agreement, and with regulations prescribed by the Secretary of Transportation and which is for the acquisition, construction, or reconstruction of a qualified vessel (as defined in § 391.11(a)(2)) or barges and containers which are part of the complement of a qualified vessel (or shares in such vessels, barges, and containers), or for the payment of the principal of indebtedness incurred in connection with the acquisition construction, or reconstruction of such qualified vessel (or a barge or container which is part of the complement of a qualified vessel).

(2) For purposes of this section the term *share* is used to reflect an interest in a vessel and means a proprietary interest in a vessel such as, for example, that which results from joint ownership. Accordingly, a share within the meaning of § 391.2(f) (relating to the definition of "agreement vessel" for the purpose of making deposits) will not necessarily be sufficient to be treated as a share within the meaning of this section.

(3) For purposes of this section, the term *acquisition* means any of the following:

(i) Any acquisition, but only to the extent the basis of the property acquired in the hands of the transferee is its cost. Thus, for example, if a party transfers a vessel and \$1 million in an exchange for another vessel which qualifies for nonrecognition of gain or loss under section 1031(a) of the Code (relating to like-kind exchange), there is an acquisition to the extent of \$1 million.

(ii) With respect to a lessee's interest in a vessel, expenditures which result

in increasing the amounts with respect to which a deduction for depreciation (or amortization in lieu thereof) is allowable.

(b) *Payments on indebtedness.* Payments on indebtedness may constitute qualified withdrawals only if the party shows to the satisfaction of the Secretary of Transportation a direct connection between incurring the indebtedness and the acquisition, construction, or reconstruction of a qualified vessel or its complement of barges and containers whether or not the indebtedness is secured by the vessel or its complement of barges and containers. The fact that an indebtedness is secured by an interest in a qualified vessel, barge, or container is insufficient by itself to demonstrate the necessary connection.

(c) *Payments to related persons.* Notwithstanding paragraph (a) of this section, payments from a fund to a person owned or controlled directly or indirectly by the same interests as the party within the meaning of section 482 of the Code and the regulations thereunder are not to be treated as qualified withdrawals unless the party demonstrates to the satisfaction of the Secretary of Transportation that no part of such payment constitutes a dividend, a return of capital, or a contribution to capital under the Code.

(d) *Treatment of fund upon failure to fulfill obligations.* Section 607(f)(2) of the Act provides that if the Secretary of Transportation determines that any substantial obligation under the agreement is not being fulfilled, he may, after notice and opportunity for hearing to the party, treat the entire fund, or any portion thereof, as having been withdrawn as a nonqualified withdrawal. In determining whether a party has breached a substantial obligation under the agreement, the Secretary will consider among other things, (1) the effect of the party's action or omission upon his ability to carry out the purposes of the fund and for which qualified withdrawals are permitted under section 607(f)(1) of the Act, and (2) whether the party has made material misrepresentations in connection